

Office of Chief Counsel
Internal Revenue Service

memorandum

CC:LM:CTM:SF:POSTF-112877-02

MTRobus

date: April 12, 2002

to: Brad Lyle, Revenue Agent (LMSB) EG:1593
Internal Revenue Service
4330 Watt Avenue M/S SA-3111
North Highlands, CA 95660

from: Area Counsel
(Communications, Technology, and Media: Oakland)

subject: [REDACTED], LLC ("[REDACTED]" and "Taxpayer")
Consent to extend statute of limitations FYE [REDACTED]

U.I.L. #: 6229.02-00
Extension by Agreement
Non-docketed Significant Advice Request ("NSAR")

Disclosure Statement

This writing may contain privileged information. Any unauthorized disclosure of this writing may have an adverse effect on privileges, such as the attorney client privilege. If disclosure becomes necessary, please contact this office for our views.

This advice is in response to your memorandum dated March 19, 2002, and relies on facts provided by you to our office. If you find that any facts are incorrect, please advise us immediately so that we may modify and correct this advice. We have informally discussed the issues herein with William A. Heard (CC:PA:APJP:BO3). This advice, however, is subject to 10-day post-review by the National Office. CCDM 35.3.19.4. Accordingly we request that you do not act on this advice until we have advised you of the National Office's comments, if any, concerning this advice.

ISSUE

20157

What is the proper language that should be used in the preparation of Form 872-P, "Consent to Extend the Time to Assess Tax Attributable to Items of a Partnership" in order for the

) Taxpayer to extend the statute of limitations for the period ended [REDACTED], or alternatively, the short year ended [REDACTED]?

CONCLUSION

The proper language is as follows:

You should identify the Taxpayer on the front page of the Form 872-P as [REDACTED], LLC. You should insert EIN [REDACTED] in the appropriate box.

The block "for the period ended" should be completed as [REDACTED]

The signature block for the Tax Matters Partner should be signed by [REDACTED] and you should type under the signature line: [REDACTED], Trustee of the [REDACTED] Trust.

DISCUSSION OF FACTS AND LAW

Facts

Background

The Taxpayer is a limited liability company organized under the laws of the State of Delaware. The Taxpayer is engaged in the business of operating a warehouse from which it distributes [REDACTED] products. Prior to [REDACTED] the Taxpayer was owned by two members as follows: the [REDACTED] Trust ("[REDACTED] Trust") and the [REDACTED] Trust ("[REDACTED] Trust"), with each trust member owning [REDACTED] units of the Taxpayer. [REDACTED] is the trustee for each trust. According to the Taxpayer's amended operating agreement dated in [REDACTED], the [REDACTED] Trust, with [REDACTED] as trustee was selected by the owners as the member-manager of the Taxpayer. According to the operating agreement, the manager is responsible for, among other duties, entering into agreements and filing tax returns.

Final [REDACTED] Return

For tax purposes, the Taxpayer, [REDACTED], LLC, elected to file federal tax returns as a partnership, filing its returns on a calendar year basis. The Taxpayer filed Form 1065, "U.S. Partnership Return of Income" in [REDACTED] for the [REDACTED] year. On the first page of the return, the box "Final return"

) was checked. The return was signed by [REDACTED] Trustee of the [REDACTED] Trust.

On the second page of the return in response to the question, "Is this partnership subject to the consolidated audit procedures of sections 6221 through 6233?" the taxpayer drew a box around the "yes" column but put an "X" in the "No" column. The Taxpayer, however, did complete the "Designation of Tax Matters Partner" ("TMP") block by inserting the name "[REDACTED] Trust" on the "Name of designated TMP" line and listing the trust's EIN and address on the lines for "identifying number of TMP" and "address of designated TMP," respectively.

Also on the second page, in response to the question "What type of entity is filing this return?" the Taxpayer checked the "Limited liability company" box. Because the Taxpayer kept its business records on a monthly basis, the amounts shown on the return reflect income and expenses as of [REDACTED].

Initial Stock Purchase and Asset Transfer Agreement

On [REDACTED], [REDACTED], Inc. ("[REDACTED]") was incorporated as a Delaware corporation. Shortly thereafter on [REDACTED], [REDACTED] entered into an "Initial Stock Purchase and Asset Transfer Agreement" ("Agreement"). Prior to the date of the Agreement, [REDACTED] had not issued any shares of stock. Under the terms of the Agreement, [REDACTED] transferred [REDACTED] shares, representing [REDACTED]% of its common stock, to the purchasers consisting of two individuals and [REDACTED] trusts, including the [REDACTED] Trust and the [REDACTED] Trust. In exchange for [REDACTED]% of the [REDACTED] stock, the [REDACTED] Trust and the [REDACTED] Trust transferred to [REDACTED] their entire interest in [REDACTED], i.e., [REDACTED] units each, constituting [REDACTED]% of the outstanding units of the Taxpayer.

[REDACTED] other purchasers transferred [REDACTED]% of the stock of a California corporation known as [REDACTED], Inc. ("[REDACTED]") to [REDACTED]. [REDACTED] thereby became a wholly-owned subsidiary of [REDACTED]. In exchange for the [REDACTED] stock, the [REDACTED] shareholders received [REDACTED]% of the stock of [REDACTED]. On the same date, [REDACTED] transferred its entire interest in [REDACTED] to [REDACTED].

For the previous fiscal year ending [REDACTED], [REDACTED] had filed a return as the parent of a consolidated group. After the [REDACTED] stock purchase and asset transfer, [REDACTED] filed the consolidated return for the year ending [REDACTED] including [REDACTED] as its wholly-owned subsidiary and the Taxpayer as a subsidiary of [REDACTED].

The parties treated this reorganization as a tax-free transfer under I.R.C. § 351, with the [REDACTED] Trust and the [REDACTED]

) Trust purportedly receiving stock equal to the fair market value of the assets transferred to [REDACTED].

Law

Classification of Organizations for Federal Tax Purposes

Pursuant to Treas. Reg. § 301.7701-3(a), a business entity that is not classified as a corporation under Treas. Reg. § 301.7701-2(b)(1), (3), (4), (5), (6), (7), or (8) (an "eligible entity") can elect its classification for federal tax purposes. An eligible entity with at least two members can elect to be classified as either an association (and thus a corporation under Treas. Reg. § 301.7701-2(b)(2)) or a partnership, and an eligible entity with a single owner can elect to be classified as an association or to be disregarded as an entity separate from its owner. The regulation also provides a default classification for an eligible entity that does not make an election. Thus, elections are necessary only when an eligible entity chooses to be classified initially as other than the default classification or when an eligible entity chooses to change its classification.

With exception to entities created prior to January 1, 1997, unless the entity elects otherwise, a domestic eligible entity is (i) a partnership if it has two or more members; or (ii) disregarded as an entity separate from its owner if it has a single owner. See Treas. Reg. § 301.7701-3(b)(1), (3).

In the present case, [REDACTED] filed a Form 1065 partnership return for [REDACTED] at which time it was owned by two members. Since [REDACTED] was comprised of more than one owner, it was ineligible to be treated as a disregarded entity. See Treas. Reg. § 301.7701-3(b)(1), (d)(2). Assuming, based on available information, that [REDACTED] is not automatically classified as a corporation under Treas. Reg. § 301.7701-2(b)(1), (3)-(8), the default rule of the regulation provides that it should be treated as a partnership for tax purposes since it is comprised of more than one owner. See Treas. Reg. § 301.7701-3(b)(1). In fact, by filing a Form 1065 partnership tax return, [REDACTED] treated itself as a partnership for federal tax purposes during the relevant period.

The general rule is that all partnerships required to file a return under I.R.C. § 6031 are subject to the TEFRA audit procedures. See I.R.C. § 6231(a)(1)(A). Small partnerships are excepted from the TEFRA audit procedures, unless they elect to be subject to them under I.R.C. § 6231(a)(1)(B)(ii). Based on the Form 1065 filed by Three A's, it is not clear whether it intended to elect to be subject to the TEFRA audit procedures. In any

event, [REDACTED] was not eligible for the "small partnership" exception because its two partner-members were trusts and hence "pass thru partners." For taxable years ending after [REDACTED] "small partnerships" are defined as those: (1) with 10 or fewer partners, (2) each of whom is an individual (other than a nonresident alien), an estate of a deceased partner, or a C corporation, and (3) none of whom are pass-thru partners. I.R.C. § 6231(a)(1)(B)(i), (a)(9); Treas. Reg. § 301.6231(a)(1)-1(a)(2).

A "pass-thru partner" is defined as any partner which is a partnership, trust, S corporation, nominee, or other similar person through whom other persons hold an interest in a partnership with respect to which TEFRA proceedings are conducted. I.R.C. § 6231(a)(9); Treas. Reg. § 301.6231(a)(1)-1(a)(2). Each partnership taxable year is examined separately to determine whether the small partnership exception applies. Treas. Reg. § 301.6231(a)(1)-1(a)(3). Since in [REDACTED] the two partners of the Taxpayer were trusts, the Taxpayer was not eligible to be excepted from the TEFRA audit procedures for the tax year ending [REDACTED].

For purposes of this "small partnership" exception analysis, we assume that [REDACTED] properly treated itself as a partnership rather than a corporation during the relevant period. If it is subsequently discovered that this classification is incorrect, i.e., that [REDACTED] should have classified itself as a C corporation for Federal tax purposes, I.R.C. § 6231(g)(1) would still operate to protect the Service, since the Internal Revenue Service make a reasonable determination that TEFRA audit procedures applied based upon [REDACTED] partnership return.

Form 872-P "Consent to Extend the Time to Assess Tax Attributable to Items of a Partnership"

In accordance with Treas. Reg. § 301.6231(a)(7)-1(a), a partnership may designate a partner as its tax matters partner for a specific taxable year only as provided in that section. Treas. Reg. § 301.6231(a)(7)-(b) provides that:

A person may be designated as the tax matters partner of a partnership for a taxable year only if that person --

(i) Was a general partner in the partnership at some time during the taxable year for which the designation is made; or

(ii) Is a general partner in the partnership as of the time the designation is made.

Treas. Reg. § 301.6231(a)(7)-1(c) provides that the partnership may designate a tax matters partner for a partnership taxable

) year on the partnership return for that taxable year in accordance with the instructions for that form.

Under Treas. Reg. § 301.6231(a)(7)-1(1), a designation of a tax matters partner for a taxable year shall remain in effect until-

- (i) The death of the designated tax matters partner;
- (ii) An adjudication by a court of competent jurisdiction that the individual designated as the tax matters partner is no longer capable of managing the individual's person or estate;
- (iii) The liquidation or dissolution of the tax matters partner, if the tax matters partner is an entity;
- (iv) The partnership items of the tax matters partner become non-partnership items under section 6231(c) (relating to special enforcement areas); or
- (v) The day on which--
 - (A) The resignation of the tax matters partner under paragraph (i) of this section;
 - (B) A subsequent designation under paragraph (d), (e), or (f) of this section; or
 - (C) A revocation of the designation under paragraph (j) of this section becomes effective.

Treas. Reg. § 301.6231(a)(7)-2 describes the rules for the designation or selection of the tax matters partner for a limited liability company ("LLC"), and provides that, for purposes of applying I.R.C. § 6231(a)(7) and Treas. Reg. § 301.6231(a)(7)-1 to an LLC, only a member-manager of an LLC is treated as a general partner, and a member of an LLC who is not a member-manager is treated as a partner other than a general partner. The regulation defines an LLC as an organization which is (i) formed under a law that allows the limitation of the liability of all members for the organization's debts and other obligations within the meaning of Treas. Reg. § 301.7701-3(b)(2)(ii); and (ii) classified as a partnership for federal tax purposes.

The regulation defines a member to mean any person who owns an interest in an LLC, and further defines a member-manager as a member of an LLC who, alone or together with others, is vested with the continuing exclusive authority to make the management decisions necessary to conduct the business for which the organization was formed. See Treas. Reg. § 301.6231(a)(7)-2(b)(2), (3). The regulation applies to all designations, selections, and terminations of a tax matters partner of an LLC occurring on or after December 23, 1996.

In the case of [REDACTED] the LLC designated the [REDACTED] Trust as the member-manager. Hence, [REDACTED]

) [REDACTED] as trustee of the member-manager was designated as the TMP on the [REDACTED] return. That designation has not been terminated. Further, the continued existence of the partnership entity itself is not essential to the operation of the partnership procedures. See *Chef's Choice Produce, Ltd., Thomas W. Burke, Jr., a Partner other than the Tax Matters Partner v. Commissioner*, 95 T.C. 388, 396 (1990). Consequently, the consent Form 872-P should be signed by [REDACTED] as Trustee of the [REDACTED] Trust. When soliciting the consent, you should provide the Taxpayer with Letter L-907 and Publication 1035, which explains a taxpayer's rights with respect to extending the statute of limitations on assessments.

Final Return for the Year Ending [REDACTED]

Section 708(b)(1)(B) of the Internal Revenue Code provides that a partnership will be considered to be terminated if within a 12-month period there is a sale or exchange of 50 percent or more of the total interest in partnership capital and profits. Treas. Reg. § 1.708-1(b)(1)(iii)(b) provides that:

(iii) For purposes of subchapter K, chapter 1 of the Code, a partnership taxable year closes with respect to all partners on the date on which the partnership terminates....The date of termination is:

(b) For purposes of section 708(b)(1)(B), the date of the sale or exchange of a partnership interest which, of itself or together with sales or exchanges in the preceding 12 months, transfers an interest of 50 percent or more in both partnership capital and profits.

[REDACTED] partnership's tax year ends on the date of termination, which was the date of the exchange by the [REDACTED] Trust and the [REDACTED] Trust of their combined [REDACTED] % ownership interest in [REDACTED] for the stock of [REDACTED]. Under Treas. Reg. § 1.443-1, a return for a short period, i.e., a taxable year consisting of a period of less than 12 months, shall be made if a taxpayer is not in existence for the entire taxable year. The return of a partnership must be filed on or before the fifteenth day of the fourth month following the close of the taxable year of the partnership. Treas. Reg. § 1.6031(a)-1(e)(2). If a partnership is terminated before the end of the tax year, Form 1065 must be filed for the short period, which is the period from the beginning of the tax year through the date of termination. Since [REDACTED] filed its returns on a calendar year basis, that short period is from [REDACTED] to [REDACTED].

) Form 1065 generally must be filed by April 15 following the close of the partnership's tax year if its accounting period is the calendar year. In general, the requirements with respect to the filing of returns and the payment of tax for a short period where the taxpayer has not been in existence for the entire taxable year are the same as for the filing of a return and the payment of tax for a taxable year of 12 months ending on the last day of the short period. Hence, unless extended, the due date of the return is the fifteenth day of the fourth month following the date of termination, i.e., [REDACTED]

Please call me at (415) 744-9217 if you have any questions.

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